

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

The Peoples Gas Light)	
and Coke Company)	
)	
Petition for an order approving the purchase)	Docket No. 11-0476
of certain securities and for authority to resell)	
those securities pursuant to Section)	
7-102 of the Illinois Public Utilities Act)	

DIRECT TESTIMONY
OF
TCHAPO NAPOE

- 1 Q. Please state your name and business address.
- 2 A. My name is Tchapo Napoe. My business address is Integrys Energy Group, Inc.
- 3 ("Integrys"), 130 E. Randolph Street, Chicago, Illinois, 60601.
- 4 Q. By whom are you employed and what is your current position?
- 5 A. My current position is Manager - Corporate Finance for Integrys Business
- 6 Support, LLC ("IBS"), which is a wholly owned subsidiary of Integrys.
- 7 Q. For whom are you providing testimony?
- 8 A. I am providing testimony for The Peoples Gas Light and Coke Company
- 9 ("Peoples Gas" or the "Company"), which is a wholly-owned indirect subsidiary of
- 10 Integrys. IBS is a centralized service company providing service to Integrys'
- 11 subsidiaries, including Peoples Gas.
- 12 Q. Please describe your educational background and business experience.
- 13 A. I graduated from the University of Wisconsin - Green Bay with a Bachelor's
- 14 Degree in Economics. I received a Masters Degree in Business Administration, with a
- 15 concentration in Finance, from the University of Arizona. I hold the Chartered Financial
- 1
- July 14, 2011

Analyst designation. I joined Wisconsin Public Service Corporation, a wholly-owned subsidiary of Integrys, in June of 2002. I have held various positions in the Treasury department and my current title is Manager - Corporate Finance. I am responsible for the issuance of long-term debt and equity securities at Integrys and its subsidiaries, including Peoples Gas.

Q. What is the purpose of your direct testimony?

A. The purpose of my direct testimony is to present and support the Company's petition for approval of its purchase of certain tax-exempt securities pursuant to Section 7-102(A)(h) of the Public Utilities Act ("Act") to the Illinois Commerce Commission ("Commission"). The purchase transaction occurred in 2008. It related to securities Peoples Gas issued pursuant to Commission approval in Docket No. 03-0548 (Order, Sept. 22, 2003) (the "03-0548 Order").

Q. Please describe the Petitioner.

A. I am advised by counsel that Peoples Gas is a corporation organized and existing under the laws of the State of Illinois, with its principal place of business at 130 East Randolph Street, Chicago, Illinois 60601. Peoples Gas is engaged in the business of purchasing natural gas for and distributing and selling natural gas to approximately 819,000 customers in the City of Chicago, Illinois.

Q. Why didn't the Company petition the Commission for approval to purchase these securities prior to the 2008 transaction?

A. Peoples Gas is making its request to approve a purchase after-the-fact because it did not interpret the Act as requiring Commission approval since the underlying IFA Series 2003D bonds had \$0 value. Until recently, it did not know that the Commission

would construe the transaction in question, which I describe below, as an “investment” requiring prior approval under Section 7-102(A)(h). Its request is based on the Commission’s May 4, 2011 decision in Docket No. 11-0269, where the Commission found that a proposed transaction that would include the acquisition of certain securities constituted an investment that required prior Commission approval under Section 7-102(A)(h) of the Act. Docket No. 11-0269, Interim Order, May 4, 2011 (the “11-0269 Interim Order”). The purchase that is the subject of this filing is similar to the proposed transaction discussed in the 11-0269 Interim Order, and it has already occurred.

Q. Please provide the history of the securities being discussed.

A. In 2003, Peoples Gas requested authority through an Informational Statement filed under Section 6-102 of the Act to issue up to \$177 million principal amount of bonds to the Illinois Finance Authority’s (“IFA”) predecessor¹. The Commission approved the request, which is the 03-0548 Order that I referenced above. The IFA is a conduit through which Peoples Gas was able to access the tax-exempt debt market. Peoples Gas issued \$102 million of the bonds authorized by the 03-0548 Order on October 9, 2003, and it denominated \$51 million of these bonds as Series PP. As described in the Commission’s 03-0548 Order, the IFA contemporaneously issued IFA Series 2003D bonds to investors and lent the proceeds to Peoples Gas. Peoples Gas then used the proceeds to redeem its Series DD, EE, II and JJ bonds.

On April 17, 2008, Peoples Gas purchased the IFA Series 2003D bonds from the remarketing agent after they were tendered by bondholders. Initially, the IFA Series 2003D bonds were in a 35-day auction mode. An “auction mode” means that the rate

¹ The Illinois Development Finance Authority (“IDFA”) was the predecessor of the IFA. The IFA was created on January 1, 2004, following the consolidation of seven existing state authorities, including the IDFA, into this new organization. For simplicity, I will refer to IDFA and IFA as the IFA.

was set periodically through an auction process, and, if the auction failed, there was a default rate. To effectuate the Company's purchase of the bonds, the Company issued a notice of auction mode conversion (from 35-day to weekly) triggering the mandatory tender of the bonds from investors. The IFA Series 2003D bonds were remarketed to the Company in the weekly auction mode².

Q. What were the market conditions at the time the Series PP bonds were retired in 2008?

A. Prior to the Company's decision to retire the liability associated with Series PP, the interest rate was set through auctions that occurred every 35 days. These auctions started failing in early 2008. The failed auction rate is 175% of the higher of (1) the 1-month London Interbank Offer Rate ("LIBOR"), or (2) the Securities Industry and Financial Markets Association Municipal Index Rate, up to a maximum rate of 14%.

Q. Why did the Company decide to retire the Series PP bonds?

A. The Company relied on its observations of failed auctions resulting in increasingly higher rates to arrive at the decision to retire the Series PP bonds. Since the interest rate on these securities was set in auctions held every 35 days, the expectation was that their rates would be similar to one-month commercial paper rates. However, the failed auction rate immediately preceding the repurchase of the IFA bonds associated with Series PP was 5.5% compared to one-month commercial paper rates of approximately 2.5% to 3% and 10-year long-term debt rates of approximately 5.25% to

² Peoples Gas disclosed this purchase in its December 31, 2008 Form 21 ILCC, its Supplemental Report in Docket No. 03-0548, filed February 27, 2009, in Staff Data Requests FIN 4.03 and FIN 4.06 of its rate case filing in Docket Nos. 09-0166/09-0167 (cons.), and the purchase is listed in Schedule D-3 of its rate case filing in Docket Nos. 11-0280/11-0281 (cons.).

5.75%. The Company's decision to retire Series PP to avoid the risk of potentially being required to pay the maximum failed auction rate of 14% was prudent.

Q. How did the Company finance the purchase of the IFA Series 2003D bonds?

A. The Company financed the purchase of the IFA Series 2003D bonds with cash on hand.

Q. Who holds the Series PP bonds?

A. The Series PP bonds were issued to reflect the liability the Company had to the IFA. The Series PP bonds were never owned by any investors. Since the Company now owns the IFA Series 2003D bonds, the Company retired Series PP, removing it from the balance sheet for accounting purposes to reflect the extinguishment of its liability to the IFA.

Q. Why did the Company use this method to purchase the IFA Series 2003D bonds and keep them on the shelf?

A. At the time, the Company believed that this was the quickest and least expensive way to reduce what it perceived as being considerable interest rate risk while retaining the option to issue tax-exempt debt under more favorable conditions in the future. As stated above, the Company was already paying more than 250 basis points above prevailing commercial paper rates and perceived a great deal of volatility in the market which could quickly widen that spread. By keeping the IFA Series 2003D bonds on the shelf, the Company retained the option of re-issuing them in the tax-exempt market either as auction rate securities or in another mode.

Q. Please explain how the Company would be able to re-issue the IFA Series 2003D bonds in the tax-exempt market?

104 A. The IFA Series 2003D bonds were issued as multi-modal bonds. Multi-modal
105 bond instruments have evolved in the municipal market to allow tax-exempt issuers the
106 ability to access capital in both a variable rate and fixed rate mode. Even though the
107 IFA Series 2003D bonds were issued in an initial 35-day auction mode, they could be
108 re-issued under a daily, weekly, quarterly, semiannual, term, or flexible rate mode.

109 Q. Why does the Company request that the Commission authorize the purchase
110 transaction entered into in 2008?

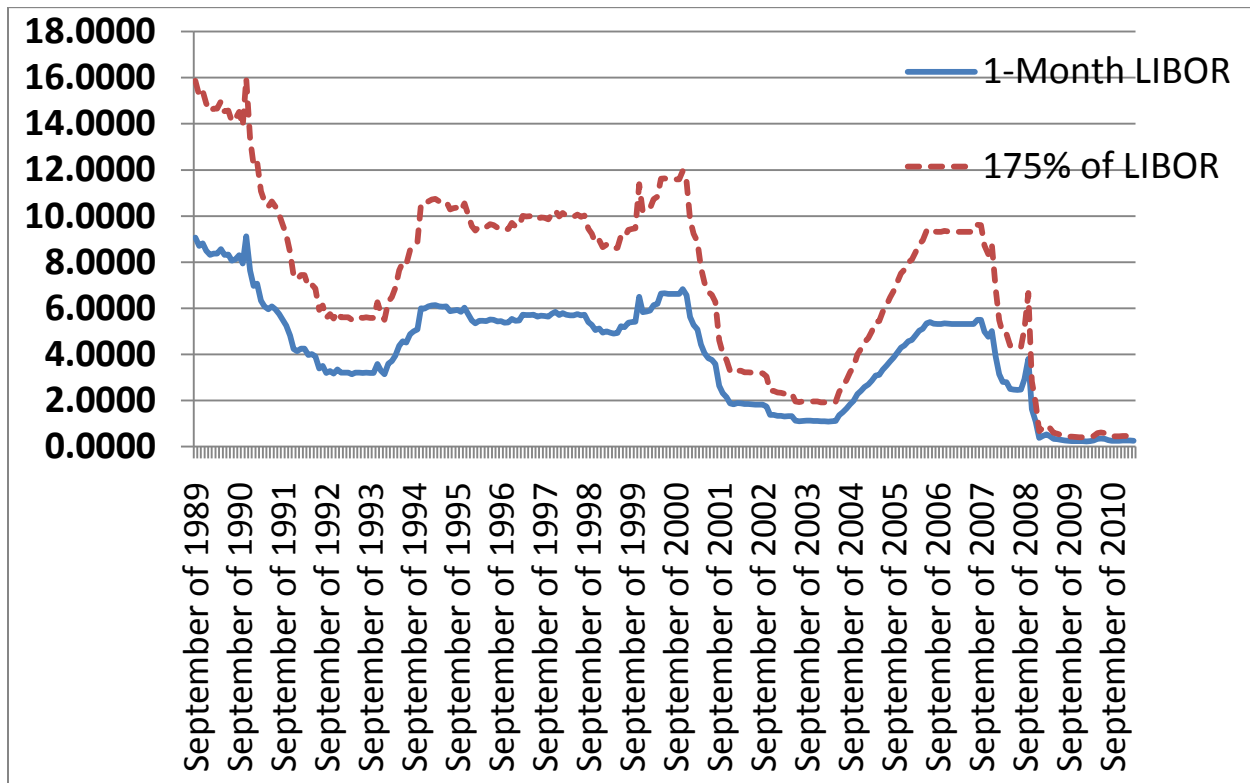
111 A. Based on the aforementioned 11-0269 Interim Order citing Section 7-102(A)(h),
112 Peoples Gas believes that the Commission would regard the Series 2003D bonds it
113 holds as an investment in the IFA.

114 For the reasons stated in its pleadings in Docket No. 11-0269 and summarized in
115 the 11-0269 Interim Order, Peoples Gas respectfully disagreed that the type of
116 transaction at issue was an “investment.” Consequently, it did not file for authority prior
117 to the 2008 purchase. However, Peoples Gas filed a Petition to open this proceeding to
118 try to remedy what it expects the Commission would conclude was a failure to satisfy
119 the Section 7-102(A)(h) requirements.

120 Q. Why should the Commission approve the transaction?

121 A. The transaction was prudent and the public was inconvenienced by the purchase.
122 The transaction allowed Peoples Gas and its ratepayers to mitigate interest rate risk.
123 The failed auction rate on the Series PP bonds was 175% of one-month LIBOR, capped
124 at 14%. Peoples Gas paid a failed auction interest rate as high as 13.93% in October
125 2008 for similar bonds that remained outstanding. The transaction limited Peoples Gas’

and its ratepayers' exposure to such volatile interest rates. The following LIBOR chart illustrates the volatility being referred to:



Q. Does the Company still request that the Commission authorize Peoples Gas to enter into a future resale transaction of the IFA Series 2003D bonds?

A. No. Peoples Gas no longer intends to resell the IFA Series 2003D bonds. Peoples Gas now intends to close down the conduit thereby retiring the IFA Series 2003D bonds. Since the IFA Series 2003D bonds will now be retired, Peoples Gas withdraws its request for a future resale transaction.

Q. Why will Peoples Gas retire the IFA Series 2003D bonds?

A. Peoples Gas planned to resell the IFA Series 2003D bonds if the auction rate securities market recovers or if the tax-exempt market recovers. Traditionally, tax-exempt debt had lower interest rates than comparable taxable debt, all things being

139 equal. Since the financial market crisis of 2008, long-term tax-exempt interest rates
140 have been typically higher than long-term taxable interest rates. It is unclear that the
141 auction rate securities market will recover in the foreseeable future or that the interest
142 rate advantage of long-term tax-exempt bonds will return. Based on those market
143 expectations and to simplify the approvals requested, Peoples Gas intends to retire the
144 IFA Series 2003D bonds and close down the IFA conduit consistent with its motion
145 under Docket No. 11-0477.

146 Q. Does this complete your direct testimony?

147 A. Yes.